

Initial Statement of Reasons/Plain English  
Overview/Non-Controlling Summary

Regulation 1525.2, Manufacturing Equipment

Regulation 1525.2 interprets and explains the application of sales and use tax to sales of equipment used in the manufacturing process to qualified manufacturers. It explains when such sales are subject to sales and use tax and when they are not.

Specific Purpose

The purpose of the proposed amendments is to interpret, implement, and make specific Revenue and Taxation Code section 6377. These amendments are necessary to provide guidance to that portion of the public which is affected by this statute.

Factual Basis

Regulation 1525.2 discusses the application of tax to sales to qualified manufacturers of equipment used in the manufacturing process. In part, it provides that consumables— i.e., items having a useful life of less than one year— are not tangible personal property for the purpose of the partial tax exemption provided by section 6377. The regulation provides that one of the criteria for determining whether or not the property constitutes a “consumable” is whether or not it has a unit cost of \$250 or less.

The Board has learned that the threshold amount is difficult to apply in practice because property that may qualify for the manufacturing equipment partial exemption covers an extremely broad range of products and is sold by a wide variety of retailers. As a result, the same item may be sold by different retailers at greatly varying prices. Retailers remain concerned, however, regarding issues of good faith when a general retailer accepts a manufacturer’s exemption certification for small dollar items purportedly qualifying as manufacturing equipment. The Board thereupon concluded that the threshold amount should be eliminated and a presumption be added that the treatment of the property for income tax purposes as having a useful life of less than one year provides a rebuttable presumption that the property has for the purposes of this regulation a useful life of less than one year. In addition, for the protection of retailers, a presumption was added that a retailer takes an exemption certificate from a qualified purchaser in good faith in the absence of evidence to the contrary. “Evidence to the contrary” is defined as the retailer’s direct knowledge that the property does not have a useful life of more than one year or that the manufacturer intends the property for his own use or is not purchasing the property for use in a manufacturing activity. In addition the rule that a purchaser who purchases property free of tax by issuing an

exemption certificate who does not use the property in an exempt manner is liable for tax on the purchase is added for clarity.

Initial Statement of Reasons/Plain English

Overview/Non-Controlling Summary

Regulation 1525.2

Page 2

In addition, for formatting purposes, the word “subsection” is replaced throughout the regulation by the word “subdivision.”

Subdivision (b)(9)(B) - phrases and “or ... less” and “for ... regulation” deleted; phrase “For ... presumed” and last sentence added. Subdivision (b)(10)(B) - phrase “be presumed to” added to current last sentence; new last sentence added. The changes provide rebuttable presumptions that (1) property treated by the buyer for income tax purposes as having a useful life of less than one year is a “consumable” within the meaning of section 6377; and (2) a retailer who accepts a 6377 exemption certificate from a qualified purchaser is doing so in good faith unless he has direct knowledge that the purchaser will put it to specified non-qualifying uses; and (3) a person issuing such a certificate who does not use the property in a qualified manner is liable for tax on the purchase. Word “subsection” replaced by word “subdivision” throughout to conform to OAL formatting requirements.

Pursuant to Government Code section 11346.5(a)(8), the Board of Equalization finds that the adoption of the proposed amendments will not have a significant adverse economic impact on private businesses or persons. The amendments are proposed to interpret, implement, and make specific the authorizing statutes in the context covered by the regulation for greater ease of understanding and to conform the regulation to recent legislation. These changes will clarify the interpretation or administration of the sales and use tax laws. Therefore, the Board has determined that these changes will not have a significant adverse economic impact on private businesses or persons.